

Internal Revenue Service

Number: **201416004**

Release Date: 4/18/2014

Index Numbers: 1362.00-00, 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-129797-13

Date:

December 12, 2013

LEGEND

X =

Trust 1 =

Trust 2 =

State =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a letter dated June 24, 2013, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

X incorporated in State on Date 1, and elected to be an S corporation effective Date 2. On Date 3, shares of X's stock were transferred to Trust 1 and Trust 2. X represents that Trust 1 and Trust 2 were each qualified to be an Electing Small

Business Trust (ESBT), within the meaning of § 1361(e), however, no election was made under § 1361(e)(3) to treat Trust 1 or Trust 2 as an ESBT. Consequently, Trust 1 and Trust 2 were ineligible shareholders, and, as a result, X's S corporation election terminated on Date 3.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(1)(B), the term "electing small business trust" means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) of the Income Tax Regulations provides, in part, that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's S corporation was terminated on Date 3 when stock in X was transferred to Trust 1 and Trust 2 because Trust 1 and Trust 2 failed to timely file ESBT elections under § 1361(e)(3). We further conclude that the termination was inadvertent within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, unless X's S corporation election is otherwise terminated under § 1362(d). Moreover, Trust 1 and Trust 2 will each be treated as an ESBT from Date 3, and thereafter, provided Trust 1 and Trust 2 file income tax returns for this period consistent with ESBT treatment.

Accordingly, X's shareholders must include in their income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided by § 1368.

This ruling is contingent on each trustee of Trust 1 and Trust 2 filing an ESBT election effective Date 3, with the appropriate service center. Each ESBT election and any amended returns must be filed within 120 days following the date of this letter, and a copy of this letter should be attached to such election and returns. If these conditions are not met, this ruling is null and void.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether X is

otherwise eligible to be an S corporation or whether Trust 1 or Trust 2 is otherwise eligible to be an ESBT.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: